

**Letter Report: Substantial Earned Income
Credit Is Paid to Non-Entitled Individuals
Who Use Not Valid for Work
Social Security Numbers**

September 2001

Reference Number: 2001-40-185

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 28, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in black ink, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - Substantial Earned Income Credit Is Paid to
Non-Entitled Individuals Who Use Not Valid for Work Social
Security Numbers

This report presents the results of our audit to determine if the Internal Revenue Service (IRS) had an effective process to prevent payment of the Earned Income Credit (EIC) to non-entitled individuals who use Social Security Numbers (SSNs) that have been issued to obtain federal benefits and are not valid for work (nonwork) in the United States. In summary, we found that each year an average of 334,000 individuals file tax returns and claim the EIC using 1 or more nonwork SSNs. These individuals may erroneously receive the EIC because the IRS does not have a process to identify and stop those tax returns before the refunds are issued. In August 1996, the IRS was authorized to deny claims for the EIC by individuals who file tax returns with nonwork SSNs issued to obtain federal benefits.

While the IRS receives data from the Social Security Administration (SSA) to identify many of the nonwork SSNs issued to individuals, the IRS does not receive available data that could help it identify the approximately 3 million nonwork SSNs that were issued before 1980. In addition, data received from the SSA do not distinguish those nonwork SSNs issued to obtain federal benefits which do not qualify for the EIC from those nonwork SSNs issued for other reasons that may qualify to claim the EIC.

We recommended the Commissioner, Wage and Investment Division: (1) develop a process to identify and prevent EIC payments to those individuals who file tax returns with nonwork SSNs issued to claim federal benefits, (2) coordinate with the SSA to ensure that all available information is obtained to identify all nonwork SSNs issued, and (3) ensure EIC eligibility information available or mailed to individuals is accurate as to whether the individuals are entitled to claim the EIC.

Management agreed with two of our three recommendations included in the report. However, management questioned the usefulness of data available by the SSA to identify approximately 3 million nonwork SSNs issued prior to 1980. Management questioned the usefulness of this data based on the fact that SSA information is over 20 years old, so many of the nonwork SSN-holders in the SSA database may be deceased or too old to still be qualifying children for EIC purposes. We agree that approximately 3 million nonwork SSNs were issued before 1980 and that these individuals may be too old to qualify as children for EIC purposes. However, this does not prevent these nonwork SSNs from being used as primary or secondary SSNs on a tax return claiming the EIC. Without the necessary data to identify the use of these SSNs, the IRS is unable to assess the revenue losses associated with erroneous claims for the EIC.

Management did not concur with our outcome measure of potential revenue protected totaling \$652 million annually. Management stated this dollar figure is overstated because TIGTA did not factor into its calculation the number of taxpayers whose situation has changed or should no longer have nonwork SSNs. We believe the outcome measure is a conservative figure. The IRS is missing data that would enable it to identify tax returns that were filed claiming the EIC with one or more of the approximately 3 million nonwork SSNs issued prior to 1980. In addition, the IRS is unable to distinguish those nonwork SSNs issued solely to claim federal benefits which do not qualify for the EIC from those nonwork SSNs issued for other reasons that may qualify to claim the EIC including those nonwork SSN holders whose situation has changed.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or M. Susan Boehmer, Acting Assistant Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

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Objective and Scope

The purpose of this audit was to determine if the IRS has an effective process to prevent payment of the EIC to non-entitled individuals who use SSNs that were issued to obtain federal benefits and are not valid for work in the U.S.

The objective of our audit was to determine if the Internal Revenue Service (IRS) had an effective process to prevent payment of the Earned Income Credit (EIC) to non-entitled individuals who use Social Security Numbers (SSNs) that have been issued to obtain federal benefits and are not valid for work (nonwork) in the United States (U.S.).

To accomplish our objective, we:

- Interviewed employees from the Wage and Investment Division to determine what actions the IRS has taken to stop refunds from being issued to non-entitled individuals who claim the EIC using SSNs that are not valid for work and have been issued to claim federal benefits.
- Used a computer program to identify the population of nonwork SSNs the IRS can identify and to determine the number of tax returns filed for Tax Years (TY) 1997 through 1999 that contained nonwork SSNs and had a claim for the EIC.
- Contacted the Social Security Administration's (SSA) Office of the Inspector General to identify information that the SSA captures that would allow the IRS to identify all nonwork SSNs issued by the SSA to date.

Fieldwork was conducted in the following Wage and Investment Division Offices: the EIC Program; Director, Submission Processing; the Director, Electronic Tax Administration; and the Communications Assistance, Research and Education/Stakeholder Partnership, Education and Communications Territory Office in Austin, Texas. Additionally, fieldwork was conducted in the offices of the Chief Counsel and Systems Development.

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The audit was conducted from February 2001 to May 2001 and in accordance with *Government Auditing Standards*. Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

Nonwork SSNs are issued to individuals who are not authorized to work in the U.S. but may need to obtain federal benefits, a driver's license, etc.

With the passage of the Social Security Amendments of 1972,¹ enacted October 30, 1972, the SSA has had the authority to issue nonwork SSNs. Since 1972, the SSA has issued almost 8 million cards with a legend of "NOT VALID FOR EMPLOYMENT" to both legal and illegal aliens who do not have Immigration and Naturalization Service (INS) authorization to work in the U.S. Nonwork SSNs are issued to allow individuals to obtain federally funded benefits (e.g., Medicaid or food stamps) or a driver's license, to register a vehicle, etc.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996,² enacted August 22, 1996, authorized the IRS to deny EIC claims to those individuals who file a tax return containing one or more nonwork SSNs issued for the purpose of obtaining federal benefits. However, the law does not prohibit individuals who receive a nonwork SSN for a reason other than to obtain federal benefits from claiming the EIC.

Some individuals who are issued nonwork SSNs later become U.S. citizens or receive INS authorization to work, thereby entitling them to claim the EIC. These individuals should notify the SSA when their work status changes. Once notified, the SSA will issue the individual a new SSA card without the not valid for employment legend.

¹ Social Security Amendments of 1972, Pub. L. No. 92-603.

² Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 2105 Stat. 110.

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The table below shows the number of individuals who filed a tax return with one or more nonwork SSNs along with the number of these individuals who claimed the EIC.

**Tax Years 1997 Through 1999
Nonwork SSN Tax Returns Filed and
Total EIC Dollars Claimed³**

Tax Year	Tax Returns Filed With Nonwork SSNs	Total Tax Returns Filed With EIC Claims	Total EIC Paid
1999	801,346	307,937	\$651,644,633
1998	815,570	337,760	\$712,278,087
1997	805,260	356,300	\$733,801,715
Average	807,392	334,000	\$700,000,000

Source: Treasury Inspector General for Tax Administration extract from IRS Masterfile and National Account Profile for TYs 1997 through 1999.

For those individuals who claimed the EIC on their TY 1999 tax returns, 97 percent of the total refunded amount was the EIC (approximately \$652 million was EIC, of the approximately \$672 million refunded).

Results

Each year, an average of 334,000 individuals file tax returns with nonwork SSNs and receive an average of \$700 million in EIC.

Individuals who file tax returns with nonwork SSNs that were issued to obtain federal benefits can receive refunds of the EIC because the IRS does not have a process to identify and stop the refunds. On average, 334,000 individuals file tax returns each year containing 1 or more nonwork SSNs to claim an average of \$700 million in EIC (see table above).

While the IRS receives data from the SSA to identify many of the nonwork SSNs issued to individuals, the

³ The information presented is conservative, as the IRS' Masterfile information enables identification of only approximately 5 million of the approximately 8 million nonwork SSNs issued by the SSA (see page 5).

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IRS does not receive available data from the SSA that could help it identify the approximately 3 million nonwork SSNs issued before 1980. In addition, the data that are available from the SSA do not distinguish those nonwork SSNs that were issued to obtain federal benefits from those issued for other reasons, which is necessary for EIC tax administration.

Furthermore, individuals who file tax returns with nonwork SSNs issued for purpose of obtaining federal benefits and do not claim the EIC are not excluded from the IRS' EIC eligibility notice program.⁴ Specifically, these individuals can receive a notice from the IRS that incorrectly advises them that they may be entitled to the EIC.

Substantial Earned Income Credit Is Paid to Non-Entitled Individuals Who Use Not Valid for Work Social Security Numbers

In August 1996, the IRS received the authority to deny EIC claims to individuals who file tax returns containing one or more nonwork SSNs that were issued to obtain federal benefits.

In August 1996, the IRS received the authority to deny EIC claims to individuals who file a tax return containing one or more nonwork SSNs that were issued to obtain federal benefits.⁵ Despite this authority, individuals can file tax returns with nonwork SSNs to claim the EIC without their tax return being stopped for review to ensure entitlement to the claim. In fact, for TYs 1997 to 1999, the IRS paid over \$2 billion in EIC to individuals who filed tax returns with nonwork SSNs.

⁴ The IRS' EIC eligibility program assesses tax returns filed without a claim for the EIC. Based on the tax return characteristics, the IRS may issue notices to selected individuals notifying them that they may in fact be entitled to the EIC.

⁵ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 2105 Stat. 110.

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Individuals who file tax returns with nonwork SSNs issued to obtain federal benefits are not excluded from the IRS' EIC eligibility notice program. Consequently, the IRS may be incorrectly advising taxpayers of their entitlement to claim the EIC.

In addition, individuals who file tax returns with nonwork SSNs issued for purpose of obtaining federal benefits and do not claim the EIC can subsequently receive a notice from the IRS that incorrectly advise them that they may be entitled. This results from the fact that the IRS' EIC eligibility notice program does not exclude tax return filings which contain nonwork SSNs.

For example, one tax professional wrote the IRS and explained that he had prepared his client's tax return correctly with no claim for the EIC because he knew that the qualifying children had nonwork SSNs. However, when the IRS processed the tax return, it sent the client an EIC eligibility notice informing the client that they may qualify for the EIC. The client returned to the tax professional and informed him that the IRS' guidance "...indicates he/she is eligible for the EIC and that he/she will claim the credit because he/she was told to by the IRS...."

Contributing factors

The IRS does not request data available from the SSA to identify the approximately 3 million nonwork SSNs issued prior to 1980.

- The IRS does not receive available data from the SSA to identify all nonwork SSNs issued. Specifically, the IRS can identify only approximately 5 million (63 percent) of the almost 8 million nonwork SSNs issued to date from the data it presently receives from the SSA. The IRS has not requested available data from the SSA to identify the almost 3 million nonwork SSNs that were issued before 1980.
- The data available from the SSA do not distinguish those nonwork SSNs issued to obtain federal benefits from those issued for other reasons, which is necessary for EIC tax administration. The SSA has no business need to capture information relative to why a nonwork SSN is issued; however, for tax administration the reason is necessary.

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Recommendations

The Commissioner, Wage and Investment Division, should:

1. Develop a process to identify and prevent EIC payments to those individuals who file tax returns with nonwork SSNs issued to claim federal benefits. This process must include a manner in which the IRS can distinguish those nonwork SSNs issued to obtain federal benefits from those issued for other purposes.

Management's Response: IRS management stated, "IRS and officials from the Department of the Treasury and SSA continue to hold discussions to determine the best way to identify taxpayers with nonwork SSNs who are not eligible for the EIC."

2. Coordinate with the SSA to ensure that all available information is obtained to identify all nonwork SSNs issued.

Management's Response: IRS management did not agree with this recommendation and listed the corrective action as "not applicable."

Office of Audit Comment: Management indicates that TIGTA believes SSA has information that *could* allow the IRS to identify the approximately 3 million nonwork SSNs that were assigned before 1980. During the course of the review, we provided to the IRS information that supports the fact that the SSA has data available that will allow the IRS to identify these approximately 3 million nonwork SSNs.

Additionally, management indicated that the SSA information is over twenty years old, so many of the nonwork SSN-holders in the SSA database may be deceased or too old to still be qualifying children for EIC purposes. We agree that approximately 3 million nonwork SSNs were issued before 1980 and that these individuals may be too old to qualify as children for EIC purposes. However, this does not prevent these nonworks SSNs from being used as primary or

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secondary on a tax return claiming the EIC. Without the necessary data to identify the use of these SSNs, the IRS is unable to assess the revenue losses associated with erroneous claims for the EIC.

3. Ensure EIC eligibility information available or mailed to individuals is accurate as to whether the individuals are entitled to claim the EIC.

Management's Response: IRS management stated, "We will revise Notices CP-09 and CP-27 to clarify the language regarding nonwork SSNs and EIC eligibility."

Conclusion

Each year, an average of \$700 million in potentially erroneous EIC claims is paid to an average of 334,000 individuals who file tax returns with nonwork SSNs because the IRS does not have a process to identify and prevent the refunds from being issued. Furthermore, non-entitled individuals may incorrectly receive notices from the IRS informing them that they may be entitled to the EIC.

To implement an effective process, the IRS must obtain the available data from the SSA to identify all nonwork SSNs issued. In addition, this process must include a manner by which the IRS can distinguish those SSNs issued solely to claim federal benefits from those issued for other purposes.

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Appendix I

Major Contributors to This Report

Walter E. Arrison, Assistant Inspector General Audit for Audit (Wage and Investment
Income Programs)

Michael Phillips, Director

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Robert Howes, Senior Auditor

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Appendix II

Report Distribution List

Commissioner N:C
Chief Counsel CC
Earned Income Tax Credit Program Manager W:EITC
Director, Compliance W:CP
Director, Electronic Tax Administration W:ETA
Director, Submission Processing W:CAS:SP
Director, Research, Analysis, and Statistics of Income N:ADC:R
Director, Communications Assistance, Research and Education W:CAR
Director, Strategy and Finance W:S
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
National Taxpayer Advocate TA
Office of Management Controls N:CFO:F:M
Audit Liaisons:
 Director, Compliance W:CP
 Director, Research, Analysis, and Statistics of Income N:ADC:R
 Director, Electronic Tax Administration W:ETA

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Appendix III

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Increased Revenue/Revenue Protection – Potential; \$652 million affecting 308,000 taxpayers annually (see page 4).

Methodology Used to Measure the Reported Benefit:

Based on information obtained from the Internal Revenue Service's (IRS) Masterfile of taxpayer account information, we were able to calculate the potential revenue/revenue protection that could result based on the IRS' developing a process to identify and stop claims for the Earned Income Credit (EIC) which involve nonwork Social Security Numbers (SSNs) that were issued for the purpose of obtaining federal benefits. The calculations below detail the methodology we followed:

- 1) Obtained an extract from the IRS' Masterfile identifying tax returns filed with one or more nonwork SSNs for Tax Years 1997 through 1999 (see table on page 3). **Total tax returns identified for the 3 tax years.**¹ = 2,422,176
- 2) From the 2.4 million tax returns filed with 1 or more nonwork SSNs, queried the data to identify those tax returns with an EIC claim (see table on page 3). **Total tax returns identified for the 3 tax years.** = 1,001,997
- 3) From the information in row # 2 above, computed the annual average number of tax returns filed with EIC claims involving one or more nonwork SSNs (1,001,997/3 tax years). **Average annual number of tax returns filed with one or more nonwork SSNs.** = 334,000²

¹ This figure is conservative as IRS Masterfile records contain information to enable identification of only approximately 5 million of the approximately 8 million nonwork SSNs issued by the Social Security Administration.

² Figure rounded from 333,999 to 334,000 for readability purposes.

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- 4) From the tax returns identified in row # 2 above, identified the amount of EIC that the IRS paid after any adjustments made during tax return processing (see table on page 3). **Total EIC paid for the 3 tax years.** = \$2,097,724,435
- 5) From the information in row # 4 above, computed the annual average EIC dollars paid relative to EIC claims involving nonwork SSNs (\$2,097,724,435/3tax years). **Average annual EIC paid relative to EIC claims involving one or more nonwork SSNs (potential overclaims).** = \$700,000,000³
- 6) To be conservative, used the amount of the EIC paid by the IRS in Tax Year 1999 (see table on page 3) for the potential overclaim. = \$652,000,000⁴

³ Figure rounded from \$699,241,478 to \$700,000,000 for readability purposes.

⁴ Figure rounded from \$651,644,633 to \$652,000,000 for readability purposes.

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Appendix IV

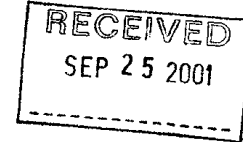
Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

SEP 24 2001



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

John M. Dalrymple
John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Letter Report – Substantial Earned Income Credit Is Paid to
Non-Entitled Individuals Who Use Not Valid for Work Social
Security Numbers

Thank you for giving us the opportunity to review and respond to your draft letter report, "Substantial Earned Income Credit Is Paid to Non-Entitled Individuals Who Use Not Valid for Work Social Security Numbers." Over the past few years, IRS has implemented many programs to prevent the claiming and issuance of erroneous EITC refunds, as follows:

- IRS revised all taxpayer assistance products to emphasize determination of eligibility. We revised the Form 1040 series instructions to enhance taxpayers' ability to determine EITC eligibility. Since the implementation of these changes, the EITC error rate has decreased significantly.
- IRS implemented statutory authority (known as "math error authority") to correct returns with incorrect EITC claims when the errors can be determined during the initial processing of returns. Research done by IRS indicates that taxpayers generally do not repeat these errors in subsequent year filings.
- IRS implemented a "pre-refund" examination process. For those errors that can be corrected only through deficiency procedures, IRS selects returns during the filing season and holds any refund until the completion of the examination.
- IRS developed a database that uses third party information such as child custody records to determine which returns to select for examination of questionable EITC claims.
- Paid preparers prepare more than 60 percent of all EITC returns, so IRS implemented a multi-year, integrated strategy to educate tax return preparers regarding common EITC errors and to examine preparer practices and propose penalties as appropriate.

While we agree some individuals with "not valid for employment" (or "nonwork") SSNs claim and receive the EITC in error, we do not agree with TIGTA on the extent of the problem as presented in this draft report. We do not concur with your claim that your "recommendations will potentially protect tax revenue of approximately \$652 million annually." Your staff discussed this benefit with IRS management; however, the draft report does not acknowledge our position that this dollar figure is overstated because

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TIGTA did not factor into their calculation the number of taxpayers whose situation has changed and should no longer have nonwork SSNs.

IDENTITY OF RECOMMENDATION 1

The Commissioner, Wage & Investment Division, should develop a process to identify and prevent EITC payments to those individuals who file tax returns with nonwork SSNs issued to claim federally funded benefits. This process must include a manner in which the IRS can distinguish those nonwork SSNs issued to obtain federally funded benefits from those issued for other purposes.

ASSESSMENT OF CAUSE

IRS has not implemented math error processing of EITC claims by taxpayers using nonwork SSNs because we do not have a way to identify those taxpayers who obtained nonwork SSNs to claim federally funded benefits. As stated in TIGTA's draft report, SSA does not capture an individual's reason for obtaining a nonwork SSN because they have no business need for this data. In addition, taxpayers do not always notify SSA of changes in their work status.

CORRECTIVE ACTION

IRS and officials from the Department of the Treasury and SSA continue to hold discussions to determine the best way to identify taxpayers with nonwork SSNs who are not eligible for the EITC.

IMPLEMENTATION DATE

June 1, 2002

RESPONSIBLE OFFICIAL

Commissioner, Wage and Investment

CORRECTIVE ACTION MONITORING PLAN

Not applicable.

IDENTITY OF RECOMMENDATION 2

The Commissioner, Wage & Investment Division, should coordinate with the Social Security Administration to ensure that all available information is obtained to identify all nonwork SSNs issued.

ASSESSMENT OF CAUSE

While the IRS already receives data from the SSA to identify many of the nonwork SSNs issued to individuals, IRS does not receive data from the SSA that TIGTA feels could help identify the approximately 3 million nonwork SSNs that SSA assigned before 1980. However, TIGTA did not study the validity or usefulness of this additional SSA

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data, particularly how it relates to EITC eligibility. This data is over twenty years old, so many of the nonwork SSN-holders in this database may be deceased (potential EITC claimants) or too old to still be qualifying children for EITC purposes. Since this SSA data is outdated, it would not be cost effective to pursue this approach.

CORRECTIVE ACTION

Not applicable.

IMPLEMENTATION DATE

Not applicable.

RESPONSIBLE OFFICIAL

Not applicable.

CORRECTIVE ACTION MONITORING PLAN

Not applicable.

IDENTITY OF RECOMMENDATION 3

The Commissioner, Wage & Investment Division, should ensure EITC eligibility information available or mailed to individuals is accurate as to whether the individuals are entitled to claim the EITC.

ASSESSMENT OF CAUSE

Individuals who file tax returns with nonwork SSNs issued for the purpose of obtaining federally funded benefits and do not claim the EITC are not excluded from the RIS' EITC eligibility notice program.

CORRECTIVE ACTION

We will revise Notices CP-09 and CP-27 to clarify the language regarding nonwork SSNs and EITC eligibility.

IMPLEMENTATION DATE

February 1, 2002

RESPONSIBLE OFFICIAL

Commissioner, Wage and Investment

CORRECTIVE ACTION MONITORING PLAN

Not applicable.

If you have any questions or need additional information, please contact me, or Candice Cromling, National EITC Program Manager, at (202) 622-5994.